SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 614

R. A. HOLMAN & CO., INC., *Petitioner,*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

R. A. HOLMAN & CO., INC., and RICHARD A. HOLMAN, *Petitioners,*

v.

SECURITIES AND EXCHANGE COMMISSION, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF FOR PETITIONERS

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I.

Respondent's efforts to evade the issue of the disqualification of Hearing Examiner Swift cannot obscure the fact that, as respondent itself wrote in an unanimous opinion at an earlier point in this proceeding, this case:

> "raises a question of first impression, having government-wide implications affecting the validity

> of all proceedings presided over by retired Hearing Examiners who have been reemployed." *In the Matter of R. A. Holman & Co., Inc., et al.*, 40 SEC 1133, 1134 (1962) (Pet. App. 95a).

Respondent first asserts that petitioner "has made no claim of actual prejudice resulting from the alleged irregularity." Respondent's Brief in Opposition, p. 15. This statement is simply incorrect. The petition states that "Petitioner R. A. Holman & Co. was clearly prejudiced by being subjected to a proceeding before a disqualified Hearing Examiner." Petition for Certiorari, p. 23. This Court has held that an agency must give weight to the decision of an "impartial, experienced examiner who has observed the witnesses and lived with the case." *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 496 (1951). Such weight was given to the Hearing Examiner's recommended decision in this case. Respondent stated in its opinion:

> "The evidence adduced in these proceedings is, in a number of instances, conflicting. In reaching our findings, we have carefully evaluated such evidence in light of the entire record, including the hearing examiner's findings." (Pet. App. 7a).

If respondent means to suggest that petitioners must claim or show actual bias against them by the disqualified Hearing Examiner, or specific actions demonstrating his partiality, such a contention is untenable.[1] Participation of a disqualified Hearing Examiner invalidates a prosecutory proceeding without regard to manifestations of actual bias and prejudice

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[1] For a thorough recent discussion of this problem, concluding that such a claim or showing is unnecessary, see Berger, *Do Regulations Really Bind Regulators?*, 62 Nw.U.L.Rev. 137, 167-171 (1967).

by him. This Court said in *United States* v. *L. A. Tucker Truck Lines,* 344 U.S. 33, 38 (1952), that:

> "the defect in the examiner's appointment was an irregularity which would invalidate a resulting order if the Commission had overruled an appropriate objection made during the hearings."

It is clear that on timely demand a litigant "is entitled to an examiner chosen as the Act prescribes," without the necessity of further demonstration of the Examiner's unfitness to serve. *Id.* at 36.

Any requirement of a showing of actual prejudice or bias by a disqualified Examiner would thwart the purpose of the statutory provisions mandating independence of tenure and compensation for Hearing Examiners. These provisions are plainly preventive in nature, designed to protect litigants and the administrative process from the subtle and insidious effects on judgment that result if an adjudicative officer is dependent for his office and sustenance on the agency which appointed him.

> "Fairness, of course, requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness . . . ." *Re Murchison* 349 U.S. 133, 136 (1955).[2]

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[2] If a claim or showing of actual prejudice to the defense of the case is required, petitioners need only point to a series of extraordinary procedural rulings by Hearing Examiner Swift which preceded the motion to disqualify him. For example, on April 24, 1962, Swift closed the hearing over the protests of R. A. Holman & Co. at a time when petitioner was still introducing evidence, had subpoenas outstanding, and had requested additional subpoenas. (Pet. App. 84a). Petitioner was required to resort for relief to the full Commission, which ordered the hearings to be reopened by the Hearing Examiner. It also ordered the is-

Petitioner's challenge to Hearing Examiner Swift was timely. It was made during the administrative hearings, and this Court has never required more than that to constitute a timely challenge to a disqualified Hearing Examiner. *Riss & Co.* v. *United States,* 341 U.S. 907 (1951).[3]

Respondent is in no position to claim that the challenge to the Hearing Examiner was untimely. The facts establishing Swift's disqualification were known at all times to respondent, yet remained buried in respondent's files and were never disclosed to petitioner until the motion for disqualification was made. It is still not disputed by respondent that prior to April 25, 1962, plaintiff had no knowledge of the facts that disqualified Mr. Swift as Hearing Examiner. Even if petitioner's counsel had known, or had reason to know, Swift's age at any earlier point in the proceedings, they had no way of knowing that Swift was serving at the will of respondent under temporary one-

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suance of additional subpoenas requested by R. A. Holman & Co., which had been denied by the Hearing Examiner. (Pet. App. 79a-81a). Other rulings against petitioner by the Hearing Examiner were overruled by the full Commission. (Pet. App. 75a-76a; 82a).

Respondent's quotation of a statement by petitioner's counsel that the Hearing Examiner "[had] acted with great patience and scrupulous fairness", Brief in Opposition, p. 15, is totally misleading. His statement was made in a pleading of April 7, 1961, shortly after the hearings commenced, and before any of the extraordinary procedural rulings by the Examiner referred to above were made.

[3] See Berger, *supra,* 62 Nw.U.L.Rev. at 170-176.

year appointments until they gained access to his personnel files in May, 1962.[4]

Thus all efforts by respondent to exorcise the issue of Swift's disqualification must fail. That issue is squarely presented by this case, is of transcendent importance, and should be resolved by this Court.

II.

Respondent's attempt to sidestep the issue of Commissioner Woodside's disqualification is equally unavailing.

Respondent first asserts that Woodside's withdrawal from the proceedings at the stage of final decision "cured any possible error" in his participation theretofore. Brief in Opposition, pp. 11-12. Woodside's eleventh hour withdrawal effected no such cure. His participation in the case as a member of respondent had continued for over four years: the original *ex parte* suspension of the Pearson offer took place September 16, 1960, and his statement of withdrawal was announced at the time of the oral argument before respondent on March 4, 1965.

During that time the case was repeatedly before the Commission on important issues arising during the proceedings before the Hearing Examiner. We know that Woodside participated in the issuance of the *ex parte* order initiating the proceedings, in the denial

[4] The discretionary power in an agency to select which of its Hearing Examiners it will retire and which it will successively reappoint is itself subversive of the Hearing Examiner system, since it holds out to a Hearing Examiner even before retirement the prospect that those with a satisfactory record of decision from the agency point of view will be selected for reappointment.

of the motion to disqualify the Hearing Examiner, and in the decision to deny subpoenas directed to proving his own disqualification, including his own subpoena. We cannot be sure how many rulings he participated in, because of respondent's practice of not noting the names of Commissioners joining in its rulings except in rare instances. But it is evident that Woodside was actively participating in these proceedings.

His last minute withdrawal, in an obvious effort to salvage the situation he had created, cannot remove the taint. Nor can the fact that the remaining members of respondent went on to decide the case without him dispel the impact of his participation in the proceedings. In the words of the Third Circuit:

> "The Board argues that at worst the evidence only shows that one member of the body making the adjudication was not in a position to judge impartially. We deem this answer insufficient. Litigants are entitled to an impartial tribunal whether it consists of one man or twenty and there is no way which we know of whereby the influence of one upon the others can be quantitatively measured." *Berkshire Employees Association* v. *NLRB*, 121 F.2d 235, 239 (3rd Cir. 1941).

The same rule was followed by the Sixth Circuit in holding that the disqualification of one Commissioner invalidated the order and decision of the agency even though his vote was not necessary for a majority. *American Cyanamid Co.* v. *FTC*, 363 F.2d 757, 767 (6th Cir. 1966).

Respondent also advances the novel notion that, even if Woodside was disqualified because of his participation in the investigation of R. A. Holman & Co. in relation to the Pearson offering, respondent's decision

may still be upheld on the basis of its findings as to the so-called Precise offering. Respondent's Brief in Opposition, pp. 12-13. But respondent itself elected to amend its original order to add these charges against R. A. Holman & Co. based on the Precise offering to the original proceedings. (Pet. App. 49a-61a). Having joined all these charges and allowed a disqualified Commissioner to sit on them, it is hardly in a position now to put them asunder for purposes of a salvage operation.

Furthermore, there is no suggestion in the opinion of the court below that it would have drawn any such distinction and would have affirmed the order and decision below solely on the basis of the Precise offering, had it found Woodside to be disqualified. It would have had no need to engage in the tortured process of upholding Woodside's qualification, if it believed that respondent's decision could stand even if Woodside was disqualified.

Finally, if Woodside was disqualified because of his participation in the investigation of R. A. Holman & Co. which led up to the administrative proceedings against it, it is impossible to see how his disqualification can be fragmented as respondent would now do. His disqualification arose from the danger of his having prejudged petitioner's guilt because of his connection with the prior investigation of petitioner's activities. The danger of prejudgment is in no way diminished simply because he may not have personally participated in the investigation of all the charges on which the proceedings to put petitioner out of business were eventually based. Prejudice and prejudgment may be divisible states of mind to respondent, but they certainly

were not to the framers of Section 5(c) of the APA, which provides flatly that:

> "No officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency in any case shall, *in that or a factually related case,* participate or advise in the decision . . . ." 5 U.S.C. § 1004(c) (emphasis supplied).

Nor are they divisible under the teaching of this Court that:

> "To perform its high function in the best way 'justice must satisfy the appearance of justice.'" *Re Murchison, supra,* 349 U.S. at 136.

Respondent asserts that the record "makes clear" that, while a member of the SEC staff, Woodside's only connection with the investigation was "a formal supervisory authority" over all activities of his division and that Woodside "had no personal knowledge of the inquiries being made." Respondent's Brief in Opposition, p. 13. The record does no such thing. It is obvious that the one person who knows whether Woodside had "personal knowledge" of the investigation of petitioner is Woodside. To this day, there has not been a single public word from Woodside stating what his personal knowledge of the investigation was. All we have ever received are statements by other people, and conclusory denials by respondent itself that Woodside had "substantial knowledge of the facts in issue," whatever that may mean. There has never been an opportunity to test even these second-hand disclaimers in an adversary proceeding, despite the clear expectation of the Court of Appeals for the District of Columbia Circuit that such a proceeding would ensue, see Petition for Certiorari, pp. 28-29.

The unfairness of the proceeding in this case is compounded by Woodside's participation in the decision to deny a subpoena for himself, by which petitioner R. A. Holman & Co. sought to make its record on the disqualification issue. It is noteworthy that respondent does not even attempt to defend its curtailment of inquiry into the facts related to Woodside's disqualification.

In the other leading cases in which the courts have dealt with similar disqualification issues, there was a personal statement by the challenged Commissioner setting forth his participation in the events leading up to the administrative proceeding and the state of his knowledge of the facts. Commissioner Cohen made such a statement in *Amos Treat Co.* v. *SEC,* 306 F.2d 260 (D.C. Cir. 1962) and Chairman Dixon did so in *American Cyanamid Co.* v. *FTC,* 363 F.2d 757, 784-87 (6th Cir. 1966).

The importance of having such a statement personally from the challenged Commissioner is self-evident. Only from such a statement can the courts perform their judicial function of determining disqualification under Section 5(c) of the APA. It is noteworthy that in the *Amos Treat* case, respondent took the same view that it does here, that the challenged Commissioner was not disqualified on the basis of his prior participation in the matter. In *American Cyanamid* Chairman Dixon took the same position. The courts disagreed when the facts were on the table.

Allowing Woodside to foreclose the inquiry by his silence and allowing conclusory denials by respondent to settle the issue puts a premium on non-disclosure. Every Commissioner challenged in the future would be encouraged to preserve silence as to his knowledge

of the facts of his own participation. This could render unenforceable the statutory prohibition of the intermingling of investigative, prosecutive, and adjudicative functions in the same individual in the same proceeding.[5]

III.

Respondent denies that the courts below in the injunction proceeding against petitioners applied a *per se* rule of fraud to the predictions of future stock price increases. In support of its contention that the courts below performed their duty of demonstrating that the predictions were without reasonable basis in fact, respondent cites one statement in the "findings" below:

> "[T]here was no basis in fact for any of these predictions." (Apps App. 408a, 422a.)[6]

This single statement is all that respondent can adduce as discussion or analysis by either of the courts below of whether there was a reasonable basis in fact for the price predictions. Its insufficiency is apparent. There is no explanation in the decisions of either of

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[5] Respondent states that the Pearson registration statement under examination in Woodside's division in 1960 was "subsequently withdrawn." Brief in Opposition, p. 5. The reason for the withdrawal was simply that Pearson was merged with Grumman Boats, Inc., and thereby strengthened its financial position. (Apps. App. 430a, Pl. Ex. 5, pp. 3-4).

[6] Like all the other findings of fact and conclusions of law made by the district court, this "finding" was proposed by respondent and rubber stamped by the district court without the change of so much as a comma. (Apps. App. 422a.)

the courts below as to why "[t]here was no basis in fact for any of these predictions."[7]

If this does not constitute the imposition of a *per se* rule in this case, it is difficult to imagine what would.[8] And as we have demonstrated, such a *per se* rule is in plain contradiction of the securities acts and their prior judicial interpretation. Petition for Certiorari, pp. 31-34.

In evident recognition that the courts below did in effect impose such a *per se* rule, respondent now attempts to uphold the injunction below on the basis of other supposed violations, apart from the predictions of price increases. Respondent's Brief in Opposition, p. 9. But this disregards petitioners' right to have their case decided under a correct rule of law. If the courts below applied an erroneous rule of law—as they plainly did with respect to the stock price predictions

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[7] It is impossible to see how the courts below could reach the conclusion without any analysis or discussion of such factors as the latest sales and earnings and the price history of the stock. "The history of prices paid in the past for stock by willing investors is one of the strongest indications of what we may expect similarly disposed investors to pay in the future, given the same or similar conditions." Plotnick & McCrane, *Fundamentals for Profit in Undervalued Stock* (1964), p. 116.

[8] The one bit of evidence respondent now points to on this issue relates to statements about increases in the market price of Pearson stock to be expected during the annual New York boat show. (Apps. App. 409a.) Even now, however, respondent makes no claim that petitioners made any false statements with respect to the history of increases in Pearson stock at the time of the boat shows. There is no dispute that the stock price had risen during all previous New York boat shows. How anyone could have been misled because he was not told that the price of the stock was slightly lower at the close of certain boat shows than at the beginning is not stated.

—it is no answer for respondent to say that they might have reached the same result on other grounds.[9]

Moreover, the other grounds relied on by respondent as justifying the injunction are trivial and insignificant, as well as invalid. For example, the district court found it to be misleading that a market letter "stated that 'working capital [of Pearson] jumped from a minus figure of $17,418 to a healthy entry in the plus column of $1,284,856,' " without stating further that this was caused by transforming a current liability of $625,000 into long-term debt. (Apps. App. 411a, 422a).

This alleged misrepresentation was not mentioned in the complaint and was only dredged up by respondent the day before the trial started, over two years after the complaint was filed. (Apps. App. 200a, 276a-277a). Furthermore, it is impossible to see how this could materially mislead potential investors. There is no dispute that the quoted statement was correct, and there is no claim of any misstatement anywhere else in the market letter. Not stating that the improvement in Pearson's working capital came from the transfer of current liabilities into long-term debt, rather than from some other source, is absolutely immaterial. Clearly, the improvement did not come from earnings, which were discussed in the market letter. (See Apps. App.

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[9] At the trial in the district court respondent pressed two principal theories of deception: (a) that failure to identify particular shares offered as having been acquired by R. A. Holman & Co., "for investment" was a material omission; and (b) that future price predictions were inherently deceptive. The Second Circuit found no basis in law to support the first of these theories and vindicated petitioners on the point. Petition for Certiorari, p. 20a. Respondent now has gone far to abandon the second theory and to fall back on minutiae.

282a). Transfer of short-term to long-term debt does improve a company's working capital.[10] What difference would it make that the improvement came this way rather than from some other source?

These are examples of the trivia which respondent now relies upon to uphold the decision below.[11] They simply represent a further effort by respondent to gloss over the clear error of law by the courts below on an important issue under the securities laws. Since a prediction of future price increase is inherent in almost every stock-buy recommendation, it is vital to the securities business to know whether a rule of *per se* illegality applies to stock price predictions.

Despite respondent's disclaimer of a connection between the two cases presented, Brief in Opposition,

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[10] In this case the short-term debt was transformed into a 10-year loan (due in 1971) at the prime interest rate and guaranteed by Grumman Aircraft Engineering Corporation (Apps. App. 181a, 430a, Pl. Ex. 5, p. 9).

[11] Similarly, respondent cites statements by a salesman to certain prospective investors about a proposed merger between Pearson and "Grumman," which supposedly did not disclose that this was "Grumman Allied" instead of its parent "Grumman Aircraft." But these would-be investors were employees of Pearson's Grumman Boat division who were well aware that Grumman Aircraft and Grumman Allied were different; they never bought any stock in reliance on these alleged misrepresentations; and one of them had been sent prior to any conversation a news clipping from the *Wall Street Journal* by the salesman stating that the stock to be exchanged was Grumman Allied. (Apps. App. 54a-60a.)

These alleged misrepresentations could not violate Section 17(a)(2) of the Securities Act of 1933 in any event, since the petitioners did not "obtain money or property" thereby, a prerequisite for statutory violation. The same is true of the alleged misstatement that the stock had not risen because of dumping of shares on the market; moreover, there was evidence of selling of large numbers of shares, accompanied by a substantial drop in the price, 15%. (Apps. App 336a-338a).

pp. 4-5, the relationship of the two is apparent. The injunction case was instituted during the stay of the administrative proceeding; respondent thwarted by court order in the administrative proceeding, resorted to the injunction suit in its pursuit of petitioners and its effort to put them out of business. In and of itself, this course of conduct by respondent represents such a departure from acceptable standards of fair dealing by an administrative agency as to justify review by this Court.

It is therefore respectfully submitted that the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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